

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Campbell Analyst: Deborah Barrett Bill Number: SB 280
Related Bills: See Legislative History Telephone: 845-4301 Introduced Date: 02-16-05
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Taxpayers' Privacy Bill Of Rights Act/Expands Scope Of Taxpayers' Rights Advocate To Include Taxpayers Privacy Rights

SUMMARY

This bill would enact the Taxpayers' Privacy Bill of Rights.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to protect taxpayers' privacy and prevent the coercion of taxpayers by actions of the Franchise Tax Board.

EFFECTIVE/OPERATIVE DATE

This bill would become effective and operative on January 1, 2006.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Taxpayers' Rights Advocate

Under current state law, the Taxpayers' Bill of Rights established the Taxpayers' Rights Advocate (Advocate) to coordinate the resolution of taxpayer complaints and problems, including any complaints regarding unsatisfactory treatment of taxpayers by department employees. The Advocate staff is required to place the highest priority on those cases where a taxpayer may suffer irreparable loss because of department action. The Advocate has authority to stay actions and toll the statute of limitations while resolving the taxpayer's concerns. Current law specifies that penalties and interest are not affected by the tolling, thus interest still accrues and penalties still apply.

Disclosure

Existing federal and state laws prohibit the disclosure of any taxpayer information, except as specifically authorized by statute. Any department employee or member responsible for the unauthorized disclosure of federal or state tax information is subject to criminal prosecution, disciplinary action, or loss of employment. Improper disclosure of federal tax information is punishable as a felony and improper disclosure of state tax information is punishable as a misdemeanor.

Board Position:

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| _____ S | _____ NA | _____ NP |
| _____ SA | _____ O | _____ NAR |
| _____ N | _____ OUA | <u> X </u> PENDING |

Department Director

Date

Gerald H. Goldberg

4/8/05

Current law and department policy provides that all information received, maintained, and generated must be treated as confidential unless it is specifically made public by statute. This includes federal, state, and local tax information, senior citizens' property tax assistance information, political reform audit information, personnel records, and criminal offender record information.

Current state law provides that a state officer or employer shall not engage in any employment, activity, or enterprise that is clearly inconsistent, incompatible, in conflict with, or inimical to his or her duties as a state officer or employee.

Written department policy lists activities that are inconsistent, incompatible, or in conflict with the duties of department employees. Incompatible activities include providing confidential information to persons to whom issuance of this information has not been authorized. Written department policy also provides rules of conduct for department employees. Department officers and employees are prohibited from:

- Disclosing confidential information in writing, electronically, or verbally to unauthorized individuals.
- Indicating or implying that an examination of a tax return will be initiated as a reprisal against anyone.

It is department policy to investigate alleged violations of law, rules, regulations, or internal policies relating to activities that are inconsistent, incompatible, or in conflict with the duties of department employees. Disciplinary action is taken under the Civil Service Act when appropriate. When there is evidence of significant criminal wrongdoing, the matter is referred to the appropriate prosecutor's office for consideration of criminal charges.

Third-Party Contacts

Current state law authorizes the department to contact third parties to obtain information to determine the taxpayer's tax liability and enforce the tax laws. Current law requires the department to notify the taxpayer that contact with a third party will be made. The purpose of the notification is to provide the taxpayer with an opportunity to volunteer whatever information is being requested. The notification is effective for 12 months. The taxpayer may request a list of third party contacts no later than 60 days after the end of the 12-month period.

Current law also authorizes the department to share confidential tax return information with other state taxing agencies, the Commissioner of the Internal Revenue Service, the Multistate Tax Commission, and tax officials from other states and Mexico. The department receives third-party data from multiple state agencies and departments for use in the tax administration activities of the department.

Judicial & Administrative Proceedings

Current state law, known as the Bagley-Keene Open Meeting Act, generally requires deliberations of multi-member state bodies to be conducted in meetings open to the public. The Board of Equalization (BOE) is a multi-member state body governed by the Bagley-Keene Open Meeting Act.

Under federal law, taxpayers disputing issues with the IRS may use traditional courts if they pay the IRS first and then sue to recover the money. The U.S. Tax Court is available to taxpayers who want to contest IRS findings before paying an assessment. The proceedings in tax court are open proceedings, and the factual recommendations as well as official opinions of the court must be made public.

Under current state law, taxpayers may appeal the department's denial of a refund claim or denial of a protest to the BOE. These appeals necessarily involve tax return information that is prohibited from disclosure under general rules. Revenue and Taxation Code Section 19545 provides a specific exception allowing disclosure of taxpayer information in a judicial or administrative proceeding. Under current law, documents submitted as part of an appeal are public records, and, under open meetings rules, oral hearings on taxpayer appeals must be open to the public. BOE then normally issues a written published opinion or unpublished decision that is also a public record.

Generally, judicial and administrative proceedings are conducted in public; however, an adjudicative body has the authority to seal the records in a proceeding in certain circumstances. Under existing law the decision to seal otherwise public records is made by balancing the public right to access adjudicative proceedings, which carries great weight, against an individual's right to privacy. When granted, orders sealing documents are narrowly and specifically written. Orders to close proceedings or seal documents from the public are extraordinarily rare.

Applicable statutes, regulations, and case law govern the admissibility of evidence offered by the parties in judicial or administrative proceedings. Rules regarding the admissibility of evidence in judicial proceedings are codified in the California Evidence Code. Rules regarding the admissibility of evidence in proceedings before BOE are found in regulations governing BOE proceedings. In general, evidence is admissible if it is relevant to the matters in dispute.

Current law provides state agencies and employees general immunity from liability for activities relating to the assessment or collection of taxes, based on California's sovereign immunity. Specific exceptions to this immunity are contained in existing law, in California's torts claims statutes, and in the Taxpayers' Bill of Rights provision allowing suit and damage recovery where a department officer or employee recklessly disregards department published procedures.

Existing law allows a taxpayer to file a lawsuit against the state if a department officer or employee recklessly disregards the department's published procedures. The law permits the taxpayer to be awarded the amount of actual damages and reasonable litigation costs. A court may impose a penalty of up to \$10,000 against a taxpayer who files a frivolous case. The California Information Practices Act allows an individual to bring a cause of action for damages for unauthorized disclosure of personal information.

Current law requires the department to adhere to the claim filing procedures of the bankruptcy and probate courts to assert the department's claims on the assets of the debtor or decedent. Proceedings in bankruptcy and probate courts are open to the public.

Current law authorizes the department to file a Notice of State Tax Lien at the county recorder's office of the various counties to establish the priority of a lien on all property and rights to property belonging to a taxpayer in that county. The file date of the Notice of State Tax Lien establishes lien priority when compared against other liens and encumbrance. A Notice of State Tax Lien becomes public record when filed at a county recorder's office.

THIS BILL

This bill would establish the Taxpayers' Privacy Bill Of Rights. Specifically, this bill would:

- Expand the Advocate's authority to review and resolve taxpayer complaints of privacy rights violations, including placing a stay on the actions under review.
- Toll the accrual of any penalties and interest during any stay of action authorized by the Advocate.
- Require the Advocate to verify that appropriate disciplinary action is taken against any department officer or employee who violates a taxpayer's privacy rights.
- Prohibit the department from releasing or threatening to release a taxpayer's personal or financial information to the general public unless:
 - The department shows a compelling interest in doing so, and
 - A court of competent jurisdiction first authorizes the release by the department.
- Make the unauthorized release of a taxpayer's personal or financial information or threat of release, whether express or implied and whether intentional or negligent, for the purpose of coercing a taxpayer to settle a liability grounds for termination of the employee or other disciplinary action.
- Prohibit the department from presenting a taxpayer's financial or personal information to a court or administrative proceeding unless:
 - The information is limited to information that is essential to the issue in the court or administrative proceeding,
 - The department shows a compelling need for information to be submitted, and
 - The taxpayer's personal or financial information is filed under seal from the public.
- Permit a taxpayer to pursue action in Superior Court if damaged by the unauthorized release or threat of release.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- This bill uses phrases and terms that need clear definitions to avoid disputes between taxpayers and the department. It is unclear whether the author intends to create new terms instead of using existing terms or whether the terms are to have similar meanings, such as "release" versus "disclose," "personal information" and "financial information" versus "tax return" "return information," and "compelling" versus "relevant."
- The provisions of this bill related to the tolling of interest and penalties while the Advocate is reviewing a taxpayer's complaint are ambiguous and may cause confusion. It appears this bill would toll the statute of limitations, interest, and penalties on *all* cases where the Advocate has stayed actions, not just cases related to privacy rights violations.
- This bill would give the Advocate jurisdiction over "any" taxpayer complaint. If a taxpayer is dissatisfied with a BOE or court decision, this bill appears to create a new right to appeal to the Advocate, thus diminishing the finality of a BOE or court decision.

- Existing law already contains a general rule prohibiting any “disclosure” unless an express exception provides otherwise. If it is the author’s intent to prevent disclosures currently authorized under existing law, unless approved by a court, it is unclear which disclosures under current law, such as for the Child Parent Locator Service, legislative committees, are considered “releases to the public” for purposes of this bill.
- Clarification is recommended to understand whether this bill would prohibit the release of public information that may be obtainable by the general public through other sources, such as Secretary of State Uniform Commercial Code filings (UCC) that by law are public records. The UCC filings with the Secretary of State serve to perfect a security interest in named collateral and contain information that could be considered “personal information.”
- This bill would prohibit “release” of certain information to the general public, unless the department shows a compelling interest for the release and a court first authorizes the disclosure. These requirements could be interpreted to prevent the current department practice of contacting third parties in the collection, audit, and criminal investigation programs. Third parties are contacted under the following circumstances:
 - Collection program: in activities ranging from locating better addresses or skip tracing, to the issuance of Earnings Withholding Orders to an employer or Orders to Withhold to levy assets to entities such as a bank,
 - Audit program: in instances where a taxpayer refuses to provide requested information relevant to substantiate an amount reported by the taxpayer on the tax return or when the department is verifying information provided by the taxpayer, and
 - Criminal investigations: when a subpoena is issued to a third party in the pursuit of criminal tax fraud or tax evasion cases.

If court approval is required prior to any of these actions and other similar actions involving third parties, the ability of the department to resolve audit, collection, or investigation cases may be hindered and the cost to complete these actions will likely increase.

Under this bill, department staff could not substantiate California's position in any forum unless the process was closed to the general public, or the department first obtained authorization to disclose this information from a court. This places additional procedural requirements on the department that could create delays in the proceedings and increase costs to defend against a taxpayer's appeal or suit for refund.

This bill would restrict the information that the department can present in a court or administrative proceeding to information essential to an issue or issues in that proceeding. It is unclear whether the department would be able to provide information to substantiate or refute a taxpayer's claims. This could result in disputes between taxpayers and the department regarding what information is essential. In addition, this bill would alter the rules of admissibility of evidence for proceedings in which the department is a party from what is relevant in the case to a new standard of what is essential. This could limit the department's ability to present relevant facts.

It is unclear how cases currently pending in judicial or administrative proceedings would be completed if this bill were enacted. Any disclosure made before this bill was enacted could be a retroactive violation.

TECHNICAL CONSERNS

On page 3, line 34, the word "not" should be inserted before "otherwise" to make the sentence regarding disclosures understandable.

The bill adds language that routinely uses the term "Franchise Tax Board." Since this bill is amending and adding a new section to the existing Taxpayers' Bill of Rights, for consistency, the term "board" should replace "Franchise Tax Board."

LEGISLATIVE HISTORY

AB 735 (Campbell, 2003) contained similar provisions to this bill. That bill did not provide for the tolling of interest and penalties. The bill was held in the Assembly Revenue and Taxation Committee.

AB 2421 (Campbell 2004) was nearly identical to SB 280. As originally introduced, the bill contained language regarding the disclosure of personal and financial information related to investigations of determining residency for part-time residents. This bill was referred to the Revenue and Taxation Committee's suspense file, with no further action taken.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved. Audit activities that are dependent upon factual development, such as residency and unitary business audits and collection activities, would likely be stopped while staff pursued court orders to obtain third-party information. Department costs could increase for advocate, audit, legal, and collection activities as a result of this bill.

ECONOMIC IMPACT

This bill would have a significant, negative impact on state income revenues exceeding \$500 million annually beginning January 1, 2006.

The department develops over \$1.3 billion annually in assessments based on audits of returns filed by individuals and corporations. In the normal course of the audit process, many of these assessments are protested, which properly brings the contested tax issues before BOE and, in some instances, the courts. The impacts this bill would impose identified under the implementation concerns, above, could prevent the department from developing a case once it is appealed. Based on the percentage of assessments and the dollar amount of those assessments that could be impacted by this bill, it is projected that this bill would impact assessments in the range of \$500 million to \$600 million annually.

In addition, the department sends out over 61,000 individual levies monthly to banks, credit unions, savings and loans and employers to attempt to collect over \$400 million in cumulative taxes owed. If the department is required to obtain a court order for each levy, most, if not all, of these collection accounts would be placed at risk due to delays caused in having to first obtain court approval.

ARGUMENTS/POLICY CONCERNS

- Requiring the records in a judicial or administrative proceeding to be sealed appears to conflict with the general policies of open meetings and freedom of information. Generally, the public has a right to know how the government administers the tax laws. This bill could result in closed hearings before the BOE. These meetings are currently open to the public. In addition, since the facts of cases would be sealed, some tax cases would no longer set precedence for interpreting tax laws.
- Allowing penalties and interest to be tolled during the stay of any action while the Advocate is reviewing a taxpayer complaint could result in the department receiving taxpayer complaints for the purpose of stopping the accrual of interest.

This bill would impose sanctions for any FTB member or employee for advising taxpayers of their rights and the consequences flowing from the exercise or refusal to exercise those rights. For example, if an employee advises a taxpayer that settlement proceeding maintains confidentiality while an appeal is a public hearing, the taxpayer could interpret this factual statement as an implied threat. This bill could authorize sanctions against the employee for informing a taxpayer of their rights. Taxpayers need department staff to be able to advise them of their rights.

This bill would require the entirety of a taxpayer's personal or financial information to be sealed in a court or administrative proceeding. Sealing records of any kind is a legal and public policy decision, made on a case-by-case basis, and already reserved for a judge under existing law.

LEGISLATIVE STAFF CONTACT

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